REPORT TO THE LEGISLATURE

Public/Private Financing Options
for
Affordable Assisted Living Housing

January 15, 1998

◆◆◆

Prepared by the Department of Human Services
Aging Initiative

444 Lafayette Road North
St. Paul, MN 55155-3844
612-296-1776

1997 Minn. Laws Chap. 961 Sec. 4

Table of Contents

Upon request, this information will be made available in another format such as Braille, large print, or audio tapes.

For More Information, contact:

Department of Human Services
Aging initiative
444 Lafayette Road
St. Paul, Minnesota 55155-3844
TDD/TTY users call
800-627-3529

Printed with a minimum of 10 percent post-consumer material. Please recycle.

Minnesota Statutes Chapter 3.197 requires disclosure of the cost to prepare this report. Approximately $2,800 for staff salaries and materials were spent to write the report.

Public/Private Financing Options
for
Affordable Assisted Living Housing

January 15, 1998

Overview:

This report discusses the **"options for public and private financing of the construction of low and moderate income assisted living housing for senior citizens throughout the state."** as required by Laws of Minnesota, 1997, Chapter 94, Section 4.

Foundation for the report includes the February, 1997 National Study of Assisted Living for the Frail Elderly, Literature Review Update, and the Minnesota INTERCOM (Interagency Long-Term Care Planning Committee) Study of September 1994, titled: "A Background Report on the Regulation of Assisted Living." The INTERCOM report was a comprehensive, multidepartmental study of cost and quality issues regarding non-institutional residential alternatives to nursing homes in Minnesota.

Since publication of these studies, changes continue to occur, not only in the availability of public and private financing options for affordable housing for the elderly, but also in the private sector's development and marketing of "assisted living" facilities throughout the state. Definitions for assisted living vary so much that no attempt was made to limit them for the purpose of the report. This approach is in keeping with the goal of encouraging the availability of a variety of housing and service options for seniors. The financing options that are discussed are applicable to many different forms of housing with services for the elderly. This report is divided into four sections:

- **Public Financing**
- **Private Financing**
- **Emerging Issues**
- **Conclusion/Future Direction**

Types of Public Financing:

Federal, State, and Local Forms of Project Financing

HUD Mortgage and Loan Guarantees /Section 232

The federal Department of Housing and Urban Development, (HUD) was authorized to issue mortgage insurance for assisted living facilities in the Housing and Community Development Act of 1992. Existing regulations were also expanded to include the refinancing of conventional assisted living facilities as well as additions to the facilities. The final rules to implement the law were published November 29, 1994 (24 CFR Part 232). Prior to that time, HUD insured mortgagees for nursing homes, ICF/MRs and board and care homes. A definition of assisted living was also published with the announcement (see Appendix I). The new law also authorized FHA mortgage insurance for assisted living facilities. These facilities can be public, proprietary or a facility of a private non-profit corporation, regulated by the State. The availability of mortgage insurance should make reliable financing easier to obtain, thereby reducing financing costs. The resulting savings could enable developers to make assisted living more affordable. The rule also creates more beneficial loan to value and debt service coverage ratios for borrowers under the program.

The Section 232 program does not offer direct loans but acts as a mortgage insurance program. which can assist developers in securing long term mortgage loans which include the construction period. There are no income limits for residents set by the program, or limits on rents and charges.

HUD Section 202 Supportive Housing for the Elderly

This HUD program provides capital advances and project rental assistance for housing for the elderly and disabled . There are provisions that make Section 202 funds useful for assisted living facility development. Funds may be used by private, nonprofit housing developers or consumer cooperatives who propose projects of up to 125 units with a 40 unit minimum for urban projects.

There are design restrictions, and services must be provided. Note: Section 202 funding is very limited, and HUD funding for community space in a project is limited to 10 percent. In October 1997, Secretary Cuomo announced that Minnesota would receive $10.6 million in HUD aid for housing elderly and disabled people through nonprofit organizations' projects.

HUD HOME/CDBG Funds
Local units of government who receive HUD HOME grants, may use the housing development funding for eligible projects. Community Development Block Grants (CDBG) may also be used for affordable housing projects. (In FY 1998, a small portion of CDBG was also earmarked for congregate housing services.) The demand for these funds, however, is high and the funds are very limited.

USDA, Farmers' Home Administration Programs
Under the Rural Development Program, the federal government provides development loans and rental assistance for cooperative, single family, and multifamily housing projects. They may be made to a variety of organizations, state, or local agencies or cooperatives. Loans are generally made in towns with populations of less than 10,000. Loans may be made for up to 50 year terms and may be used to build, purchase, or renovate housing. Projects must be located as close to service providers and shopping as possible. Units must include bathrooms and kitchens, as well as an emergency call system. All tenants must meet income eligibility criteria.

HUD Congregate Housing Services Programs (CHSP)
The federal Congregate Housing Services Act of 1978 as amended created the CHSP grant program for projects that were designed to provide a variety of innovative approaches for the delivery of meals and non-medical supportive services while utilizing existing service systems to fill gaps in order to prevent the premature or unnecessary institutionalization of the frail elderly or disabled. It was one attempt to deal with the reality of the aging in place of subsidized housing tenants.

Administered by HUD, it bridges the housing and service systems by providing funding for services. State and local government agencies may apply to sponsor a grant for a proprietary owner, because the proprietary owner is not eligible to apply directly. Local non-profit agencies are eligible to apply for five year grants for service coordination and supportive services. After that five year period, alternate sources of funding must be located. Funds may be used to retrofit an existing building for use by frail elderly, and retrofitting may also include creating space to accommodate the delivery of supportive services. The CHSP program has always been small (costing approximately $25 million per year) and often considered expendable. No new funding has been authorized for this program since FY 96.

HUD Section 8 Certificates and Vouchers
In addition to providing project based housing assistance, the Section 8 program also provides rental subsidies directly to household. These subsidies are in the form of rental certificates which

are limited to the difference between 30 percent of the tenants income and fair market rent as set by HUD. More recently, rental vouchers which, unlike rental certificates, allow tenants to pay any excess between 30 percent of income and fair market rents out of pocket have become available. Housing vouchers are intended to provide tenants with more flexibility in their choice of housing arrangements. While there has been no expansion of this program, existing subsidies continue to be available.

Mortgage Revenue Bonds
As authorized by the U.S. Treasury Department, states and certain other entities, such as state housing finance agencies, may issue bonds which fund construction and long term mortgage loans. Because the interest earned by individuals and corporations buying the bonds is exempt from federal taxes, the loan interest rate is typically lower than that of similar investments.

Under Treasury regulations, housing developments financed with the proceeds of these bonds must reserve at least 20 percent of the units for residents at or below 50 percent of median income, or 40 percent at 60 percent of median income for a minimum of 15 years. The housing must be permanent, rental housing, and apartments must include their own kitchens and baths. Certain requirements are waived if the bond proceeds are to be used by 501(c)(3) organizations.

In Minnesota, residential rental bonds could be used to finance the development of assisted living facilities. In general, Minnesota state income limits are lower than the federal income limits for use of these bonds. As with tax credits, some local units of government are suballocators of the federal bonding authority.

Essential Function Bonds
As with mortgage revenue bonds, the interest earned on essential function bonds is tax exempt from federal taxes. Essential function bonds may be used by units of local government for any corporate purpose. The 1992 Minnesota legislature extend the uses of essential function bonds and authorized local units of government to issue these bonds for the purpose of producing housing. Qualified housing development projects are defined in statute as projects which provide housing for elderly or for individuals and families with incomes not greater than 80 percent of the median family income. Essential function bonds could be used to finance assisted living developments. The basic difference between essential function bonds and private activity bonds is that essential function bonds require public ownership of the facility financed by the bond proceeds. This restriction and related requirements have limited the usefulness of the bonds for housing projects.

Low Income Housing Tax Credits
Low Income Housing Tax Credits (LIHTC) were created by the federal Tax Reform Act of 1986 to encourage the construction and rehabilitation of low-income housing. The LIHTC program provides a means by which developers may raise capital to develop low income housing by the selling the tax credits and other economic benefits to limited partner investors. The investors contribute equity capital to the development.

The MHFA awards low income housing tax credits in three competitive rounds on an annual basis. In addition to the MHFA, the suballocators of Minneapolis, St. Paul, Bloomington, Duluth, Rochester, St. Cloud, Washington County and Dakota County may accept applications for projects in their jurisdictions. Projects apply for the credits and must compete on the basis of the priorities listed in state law and other local considerations. Housing developments for the elderly are excluded from the first round which is limited to Single Room Occupancy (SRO) projects, family housing projects, or projects targeted toward special needs populations. Assisted living projects would be eligible to apply for funding under this program in the second and third funding rounds.

Any developer who uses these credits is required to comply with the affordability requirements in both federal and state law. To qualify for funding, projects must set aside at least 20 percent of the housing units for tenants whose incomes are 50 percent or less of the area's median income, or at least 40 percent of the housing units must be set aside for tenants whose incomes are 60 percent or less of the area's median income. Additional requirements include the following: gross rents cannot exceed 30 percent of the applicable income ceiling, and owners of qualified residential rental projects must satisfy the minimum set-aside and gross rent requirements for a 15 year period.

Hospital District Bonds
The legislation that authorized this study also authorized hospital districts to acquire, improve and run facilities which are defined as housing with services: Minnesota Statutes, Section 447.45 subdivision 2, paragraph (b). Assisted living facilities are considered a part of this definition. This means that the districts may borrow money and issue bonds for this purpose or enter into agreements with a city or county with respect to a certain facility.

HUD Empowerment Zone Tax Breaks and/or Grants
HUD has also recommended the use of "empowerment zones" in the development of assisted living facilities. These zones, of which there are over 100 designated around the country, including several in Minnesota, are slotted to receive as much as $100 million plus tax incentives

for businesses to locate within their boundaries. The zones, which are limited in size, are an attempt to encourage economic development in areas that are in economic decline.

Property Tax Breaks/Tax Increment Financing (TIF)
In 1997, the Minnesota Legislature passed legislation that permits owners of rental property who pledge to meet certain affordability requirements to receive a tax class rate of 1 percent of market value for land and buildings. (Class 4(d) There may be circumstances where this lower cost tax class could apply to an affordable assisted living project.

Tax increment financing is a community development financing tool used by local units of government. Typically a municipality offers to forego property taxes for a limited time above a base amount on land that is to be developed. A fully developed parcel of land will have a higher tax bill than land that is not developed. The tax "increment" received over and above the base amount is often used as an income stream to pay off bonds issued for the project. In recent years, the Legislature has placed significant limitations on the use of this financing tool by local governments. Affordable housing is one of the authorized uses for TIF.

State and Federal Individual Assistance Programs for the Elderly

Medicaid
Seniors who are in need of nursing home care, and whose income is low enough, have typically funded this care with Medicaid dollars. In the past, because nursing care was paid for by Medicaid but other forms of community based services were not, seniors were left with no choice but to enter skilled nursing homes which were often far more costly than community based care including assisted living settings. In effect, the availability of Medicaid funding skewed the senior supportive housing market.

One response, found in the Omnibus Budget Reconciliation Act (OBRA) of 1981, was for Congress to establish a waiver program to offer states alternatives to traditional long-term care services funded by Medicaid. In the past several years, a number of additional waivers have been offered through other legislation. In Minnesota, the Elderly Waiver program became available in the early 1980s. The State-funded Alternative Care Program was also developed at that time.

Medicaid funding continues to be the subject of much discussion at both the State and Federal level, particularly when housing with service options for the elderly are discussed. As it is now, nationally, 80 percent of Medicaid long-term care funds are spent on institutional nursing care, even though many studies show that older people would prefer to remain in their own homes or in home-like settings. Despite the availability of waivers, and the efforts of states to encourage home and community based care, assisted living settings are usually paid for by the residents or their families. There has been some fear, expressed by experts, that a "two tier" system will be inevitable where low income seniors are left with few housing and service options but institutional care. The impact of proposed federal Medicaid legislation on the development of housing with service alternatives for lower income residents makes the situation even more complex.

Some experts argue that any federal changes to the Medicaid program that are proposed, (including capitation or reduced federal matching funds) combined with fewer federal requirements regarding payments to nursing facilities, i.e., elimination of the Boren Amendment, will encourage states to shift Medicaid money to the assisted living sector. Others see just the opposite result with states focusing funding on the sickest of those dependent on support. States, including Minnesota continue to grapple with financing and regulatory issues in an area that has the potential for significant fiscal impact.

Minnesota Elderly Waiver (EW) and Alternative Care (AC)

The Minnesota Department of Human Services operates the EW program under a federal waiver to Minnesota's Medicaid State Plan. The waiver funds home and community based services for people 65 and older who require the level of medical care provided in a nursing home but choose to reside in the community. The programs pay for a variety of services, but by federal law, are prohibited from paying for room and board. The idea is that housing costs would be paid by waiver recipients out of their own resources. However a recipient of Medical Assistance may keep only $420 of their income before they must contribute toward the cost of their medical expenses. These contributions are the Medicaid spenddown. Recipients of benefits from certain other state or federal programs such as Supplemental Security Income (SSI), Minnesota Supplemental Aid (MSA) Group Residential Housing, (GRH) or Minnesota Family Investment Plan (MFIP) are not required to meet spenddown requirements and therefore may have additional income available to meet housing costs.

The Department also operates the state-funded Alternative Care program for people 65 and older who do not meet the income and asset standards required for the EW program. Those eligible for the EW program are 65 or older, eligible for Minnesota Medical Assistance, and determined through the Preadmission Screening (PAS) process to need nursing home level of care. Eligibility is limited by the availability of slots. The EW service cost for an individual cannot be greater than the estimated nursing home cost for that same individual. The AC Program permits a slightly higher level of income and assets. The test is whether the person's income and assets would be inadequate to fund a nursing facility stay for more than 180 days.

Covered services in the EW and AC programs include visits by various types of trained caregivers (skilled nurse, home health aide, homemaker, companion, personal care assistant) as well as home delivered meals, adult day care, respite care, transportation, supplies and equipment, devices, and certified community residential services including assisted living, foster care, and residential care. AC also includes telemedicine and chore services. In Minnesota, 9.7 percent of the elderly received publicly funded health care in FY 96 (Medicaid and Alternative Care.)

Although assisted living can be funded through AC and EW, as stated earlier, a high proportion of assisted living is currently paid for privately. In the future, there is expected to be additional pressure to increase public funding for residential alternatives. DHS and MDH will also need to determine whether Housing with Services registration (which is less stringent than nursing facility licensure) is viewed by seniors and advocates as a satisfactory level of regulation.

Group Residential Housing (GRH)
GRH is a state funded income supplement program to pay room and board costs for low income persons who reside in licensed settings with which a county human service agency has negotiated a monthly rate. In addition, GRH can pay a limited amount of service costs for elderly persons who are not eligible for EW or AC. These service costs include difficulty of care payments in Adult Foster Care settings licensed for five or fewer elderly persons.

Social Security Old Age Benefits
This basic source of senior income averages $706 per month for Minnesota's elderly recipients (1995 data.) The overall average income of a Minnesotan, age 65 or over, is $12,000. When looking at issues of affordability of housing and services, these numbers become important.

Supplemental Social Security Benefits (SSI)
SSI is for aged, blind or disabled persons whose income from any source is below the SSI limit ($494, effective 1/1/98.) Any person who receives a benefit from SSI is categorically eligible for MA (Minnesota's Medicaid Program) without a spenddown.

Types of Private Financing:

Commercial Mortgages/ Real Estate Mortgages
When financing the construction of an assisted living development, a private financial institution will underwrite it as a commercial business loan rather than a residential real estate loan. This distinction is made because an assisted living project provides more than just shelter, it also provides a range of services to its residents. This creates an obstacle to obtaining private financing

because a commercial business loan requires significantly more collateral than a residential real estate loan. Private financial institutions currently require sizable down payments as well for loans for the construction of assisted living facilities. Nationally, private financial institutions are seen as unwilling to provide long term financing for assisted living projects. Typically, banks will not provide financing for a term longer than 5 to 7 years. At the end of this period, the developer must arrange for take-out financing. Federal mortgage insurance programs could be used to assist developers to obtain long term mortgage loans, but sometimes requirements are too complex, particularly for small banks who may only do a limited number of such loans.

Banks may be reluctant to finance assisted living projects whether the project is targeted toward either private or public pay residents. If the project is designed for private pay clients, banks may be reluctant because many believe that this is a very thin market. On the other hand, if the proposed assisted living project is intended for publicly subsidized clients, many banks are reluctant to make loans because they do not understand the funding systems.

Financial institutions typically distinguish between financing the conversion of existing facilities and financing new construction. Generally, conversions are perceived to be more risky because of unforeseen problems. As a result, most banks will require building in an extra margin for potential cost overruns. Other issues in commercial lending include the use of fixed versus floating rate mortgages, the sale/leaseback format, and the availability of construction financing.

Initial Public Offerings of Stock

Another possibility that is discussed in the literature is the option of going public with a stock offering. Recently, initial public offerings (IPO's) and subsequent public offerings for several national housing corporations have raised speculation about the usefulness of this method of capital development. Issues regarding SEC oversight of financial records and activities were cited as the most significant disadvantage along with the more typical risks of the stock market. The usefulness of this option to private companies in Minnesota is dependent upon each business' unique character and size.

REITS and Insurance Companies

It is expected that, as the industry expands and secures its market niche in housing development, commercial banks and insurance companies as well as real estate investment trusts (REITS) and community banks and S&'s will provide capital for assisted living facilities. Often, these forms of private financing are dependent on the size of the companies and nonprofits involved in development. Commercial lenders will also be paying careful attention to any changes to federal Medicaid and state waiver programs in making lending decisions, as well as to HUD guarantee programs.

Charitable and Nonprofit Financing/ Joint Ventures

Nationally, there are examples of a few public/private initiatives in assisted living that are targeted to low income frail elderly. Some experts argue that collaboration can minimize costs and make opportunities for community contribution to a project. For example, donated land or funds can reduce the overall cost of debt for a project. Other examples include using a 501(c)(3) joint venture organization to qualify for special real estate or other tax breaks. Private donations can be leveraged with other public sources of financing, including tax exempt bonds. Finally, the negotiation of lower cost developer and architect fees might be more feasible with a public/private joint venture.

Emerging Issues in Affordable Senior Housing

Issues in Public Financing

In general, public financing tools are very limited in their availability. When applying priorities to applications for public financing, senior housing projects are often lumped together despite the fact that there is a wide spectrum of housing and housing with service options. The State may have an interest in reviewing existing public funding priorities to consider:

- Accommodating changing individual and community needs, particularly as baby boomers age.
- Urban/rural and other regional issues in affordable senior housing.
- Assessing the impact of financing a project on other publicly funded programs, i. e., Medicaid.
- Focusing on the preservation of existing affordable housing infrastructure.
- Encouraging public/private development and management models.
- Encouraging the conversion of existing nursing home facilities to a more flexible housing and services model.

(A recent DHS report to the Legislature notes, however, that in the 1997 Session, DHS proposed incentive payments of up to $1,000 per bed for nursing facilities to close their operations, with priority given to those NFs that planned to convert their operations to community-based services for elderly persons or some other services for the public good. This proposal did not generate

any interest from the nursing home industry. The study went on to say that "if the State wishes to promote conversion of facilities to assisted living settings, a more thoughtful process, perhaps through a focused demonstration and request for proposals (RFP) process would be more successful in identifying and converting the best candidates.")

Issues in Private Financing

In general, the experience and equity involvement of a developer has the most significant impact on the availability and cost of private financing for a project. The adequacy of a marketing study for the project will also be important. Access to federal mortgage insurance, and the attendant requirements or limitations, will also affect financing availability and affordability. As bankers and investors become more familiar with the assisted living industry, financing should also become more available. Indeed, in "Investor's Guide '97," *Fortune* ranked assisted living as one of the top potential growth industries of the year, given the undeniable demographics of an aging America.

Affordability of assisted living, itself, is a complex issue and not limited to consideration of the capital financing costs of a project. Operating and regulatory expenses, as well as the availability and stability of individual income/public subsidy, and the strength of the housing market in general, have an impact on affordability.

There are a number of issues, however, that affect the availability and affordability of private financing that are related to state policy and practice. The role of the State in the following areas should be reviewed as a part of any discussion of private financing options:

- The impact of state policies, funding practices, and standards on the need to reduce barriers to private financing, foster competition, and encourage the development of a wide range of affordable housing options.

- The impact of assisted living projects on the provision of "institutional" services also needs to be considered. The recent development of assisted living settings in Minnesota that are very similar to nursing homes in design and services could be viewed as a possible erosion of the nursing home moratorium. There is no moratorium on development of assisted living projects.

- The impact of the increasing complexity of regulation of housing with services and the need to educate lenders about federal and state programs that license and pay for housing and/or services to seniors.

Lack of Affordable Rental Housing in Minnesota

While the supportive housing market in Minnesota is just emerging, trends in the broader housing market will have an impact on availability and affordability of specialized housing and services. In Minnesota, nearly one third of all households eligible for rental assistance (households with income less than $12,000 and who spend more than 30 percent on rent) are over the age of 65 (28,251 households.) One fourth of all eligible households are single elderly women over the age of 65 years (22,517 households). from: MHFA Needs Assessment, July 1995.

More recently, the affordable housing market, particularly in the metro area has become even tighter. Vacancy rates are at an all time low, making this a landlord's market. It is unknown what impact these market realities will have on the demand for assisted living units.

Use of Existing Senior Housing /Loss of Existing Section 8 Units and Projects

In Minnesota, there are approximately 515 federally assisted housing developments, with approximately 30,000 affordable housing units. It is estimated that 10 percent of these developments will choose to prepay their mortgages. With prepayment, restrictions requiring low and moderate income occupancy would be terminated. Over one-half of the federally assisted housing developments are for the elderly. Loss of these units could put an even greater emphasis on the need for nonprofit or private development of affordable living options. As a practical matter, subsidized housing projects, when well coordinated with community-based services, often become a substitute for more formal assisted living situations. The simple fact that many residents are aging in place, and becoming more frail as they live in federally subsidized housing has created a need to focus on services for these individuals. Again, the impact on the demand for assisted living units is unknown.

The recent elimination of federal rental priorities in existing subsidized housing may also affect the affordable housing market for the elderly as local housing officials create their own priorities for serving the public.

Conclusion/Future Direction:

The issue of financing options for affordable senior housing with services needs to cover more territory than traditional topics of mortgage rates, insurance, or public/private financing availability. The trend is to look more carefully at the individual resources of the person, including the safety net payments from Medicaid and SSI and associated state programs as possible sources of funding for a variety of forms of "assisted living." Minnesota's experience with nursing home development and use, however, is an example of how the availability of certain forms of funding (Medicaid) can be used to support a costly, inflexible, and highly regulated system that ties housing to receiving services. The State's goal for the future should be to support new financing mechanisms and new housing options without creating inflexible models of service delivery as has happened in the past. Emerging issues that need to be addressed include:

- The importance of supporting the aging in place of seniors, where appropriate, whether in their own homes, or in rental housing.
- Methods of preserving or making better use of existing senior housing and nursing facilities.
- Ways to support communities in their efforts to provide lifecycle housing to maximize choice in the types of housing and services available.
- The need to review existing state regulatory practices to reduce barriers to private financing of senior housing options.
- The need to educate private providers of financing for housing with services about the resources and priorities of seniors and the regulatory framework in Minnesota.

24 CFR Part 232 Section 232.1 Definitions.

(m) Assisted Living Facility means a public facility, proprietary facility, or facility of a private nonprofit corporation that is used for the care of the frail elderly, and that:

(1) Is licensed and regulated by the State or if there is not State law providing for such licensing and regulation by the State, by the municipality or other political subdivision in which the facility is located;

(2) Makes available to residents supportive services to assist the residents in carrying out activities of daily living such as bathing, dressing, eating, getting in and out of bed or chairs, walking, going outdoors, using the toilet, doing laundry, preparing meals, shopping for personal items, obtaining and taking medications, managing money, using the telephone, or performing light or heavy housework, and which may make available to residents home health care services, such as nursing and therapy;

(3) Provides separate dwelling units for residents, each of which may contain a full kitchen or bathroom, and includes common rooms and other facilities appropriate for the provision of supportive services to residents of the facility.

Note: Other regulations require the mortgagor to provide assurances satisfactory to the Secretary of HUD that no dwelling unit in the facility will be occupied by more than one person without the consent of all occupant(s) of such dwelling unit. See Sec. 232.7(b).